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International financial system and development

Report of the Secretary-General**

Summary

The present report, submitted pursuant to General Assembly resolution 69/206, summarizes information on recent trends in international official and private capital flows to developing countries and ongoing efforts to strengthen the international financial system for the implementation of the forthcoming 2030 agenda for sustainable development. It also highlights relevant agreements and commitments of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, with regard to official development assistance, financial regulation, sovereign debt distress, the global financial safety net, multilateral surveillance, policy coordination and governance reform of the international financial institutions.

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** The present report was prepared in consultation with staff of the major institutional stakeholders involved in the financing for development process. Responsibility for its contents, however, rests solely with the United Nations.

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I. Introduction

1. The General Assembly, in its resolution 69/206, recognized the need to continue and intensify efforts to enhance the coherence and consistency of the international monetary, financial and trading systems, reiterated the importance of ensuring their openness, fairness and inclusiveness in order to complement national efforts and achieve sustainable development, including the internationally agreed development goals, and reaffirmed the need for significant mobilization of resources from a variety of sources and the effective use of financing in order to promote full and productive employment and decent work for all.

2. At the third International Conference on Financing for Development, held from 13 to 16 July 2015 in Addis Ababa, Heads of State and Government and high-level representatives considered issues related to financing development gaps and achieving sustainable development in all its three dimensions and adopted the Addis Ababa Action Agenda of the Third World Conference on Financing for Development.[1] Although the needs in this field are enormous, the Action Agenda observed that the challenge of meeting them was not insurmountable. Furthermore, as noted in the report of the Intergovernmental Committee of Experts on Sustainable Development Financing, available global public and private savings would be sufficient to finance the investments necessary to achieve sustainable development for all.[2] However, current investment patterns need to be changed. While there is no one simple policy solution, the Action Agenda underscored the importance of enabling domestic and international environments for securing finance on a sustainable basis. It stressed that mobilizing the necessary resources would require a concerted effort that drew on all actors and all resources, including public, private, domestic and international resources. As recognized in the Monterrey Consensus and reaffirmed in the Doha Declaration and the Action Agenda, countries are responsible for their own economic and social development. At the same time, national development efforts need to be supported by an enabling international environment, including a stable international financial system, coherent and mutually supporting world trade, monetary and financial systems, and strengthened and enhanced global economic governance.

II. International financial flows to developing countries

A. International public finance

3. As recognized in the Addis Ababa Action Agenda, achieving the ambitious post-2015 development agenda, including the sustainable development goals, puts significant demands on public budgets and capacities, requiring scaled-up and more effective international support, including both concessional and non-concessional financing.

Quantity of development assistance

4. Net official development assistance (ODA) from member countries of the Organization for Economic Cooperation and Development (OECD) and its

[1] Resolution 69/313, annex.

[2] A/69/315, paras. 22 and 36.

Development Assistance Committee has increased substantially since the Millennium Declaration, and is estimated to have reached $135.2 billion in 2014,[3] after falling to $132.4 billion in 2011 and to 127.6 billion in 2012 in the aftermath of the world financial and economic crisis and fiscal stresses in some European countries. Only five members of Development Assistance Committee exceeded the commitment to achieve the target set by the United Nations of disbursing 0.7 per cent of their gross national income (GNI) as ODA. Collectively, ODA amounted to 0.29 per cent of donor GNI in 2014, leaving a delivery gap of $191 billion, or 0.41 per cent of GNI.

5. The sectoral allocation of ODA during the era of the Millennium Development Goals (2000-2015) reflected the emphasis of the Goals on basic social needs, most prominently in the areas of health and education. More recently, there has also been a rapid increase in climate-related ODA. Between the 2007-2009 and 2010-2012 periods, such assistance increased by 150 per cent, to an average of $21 billion per year in the latter period. While there is broad agreement that all ODA should be climate-sensitive, there are concerns about the implications of this trend for the allocation of ODA, as climate-related ODA tends to benefit middle-income countries disproportionally.[4] Moreover, this may affect the additionality of climate financing.

6. While ODA to the least developed countries increased substantially, more than doubling from $21.6 billion in 2000 to $45.8 billion in 2010, it has fallen in recent years. The reduction in aid to those countries was particularly pronounced in 2011 and 2012. Preliminary data from 2014 indicate a continued fall in bilateral ODA, totalling 16 per cent in real terms. In countries in Sub-Saharan Africa, there was a decrease in bilateral aid of about 5 per cent in real terms in 2014. At the third International Conference on Financing for Development in Addis Ababa, developed countries agreed to halt the decline in ODA to the least developed countries. The Addis Ababa Action Agenda encourages developed countries to increase the target for ODA to the poorest countries to 0.2 per cent of GNI, and welcomes the European Union's commitment of the European Union to spend 0.7 per cent of GNI on aid, with 0.2 per cent going to the least developed countries by 2030.

Effectiveness of development cooperation

7. In addition to commitments to increase the quantity of ODA, the international community has also worked to strengthen its quality and effectiveness. Despite some progress in implementing the work plan of the Development Assistance Committee on aid effectiveness, only one of the 12 agreed indicators was fully realized by the time of the final review in 2011, underlining the political and administrative hurdles to changing aid relationships. To reinvigorate the process, a broader group, including Governments, bilateral and multilateral organizations and representatives of civil society and the private sector, created the Global Partnership for Effective Development Cooperation, aiming for more comprehensive monitoring and the sharing of policy lessons. The Development Cooperation Forum, which meets under the auspices of the Economic and Social Council, also supports

[3] OECD, "Development aid stable in 2014 but flows to poorest countries still falling", Paris, 2015.

[4] Overseas Development Institute, World Resources Institute and Institute for Global Environmental Strategies, 2013, "Mobilizing international climate finance: lessons from the fast-start period".

development effectiveness, particularly by facilitating monitoring, review and accountability of both providers and recipients of development cooperation.

8. Overall, one can point to progress made, such as in untying aid, in reporting ODA in national budgets of aid-receiving countries, and in using country administrative systems in the management of aid-funded programmes and projects. Nonetheless, conditions that donors attach to ODA remain burdensome, internal procedures by donors remain complex and the fragmented landscape continues to pose coordination challenges. The Addis Ababa Action Agenda emphasizes the importance of strengthening the effectiveness and improving the quality of ODA and calls for the provision of data on aid effectiveness and evidence of tangible results.

9. Financial and technical cooperation among developing countries is playing an increasingly important role in development. Estimates based on available data show that South-South development cooperation may have reached $20 billion in 2013 as a result of a major increase in contributions from some Arab countries.[5] Developing countries have also taken steps to establish new development finance institutions, notably the New Development Bank and the Asian Infrastructure Investment Bank, which are expected to provide and leverage substantial additional resources, especially in support of infrastructure development. The two banks have an initial authorized capital base of $100 billion each, and both financial institutions are expected to be fully operational in 2015. These new initiatives have been welcomed in the Addis Ababa Action Agenda, which encourages developing countries to voluntarily step up their efforts to strengthen South-South cooperation and to further improve its development effectiveness in accordance with the provisions of the Nairobi outcome document of the High-level United Nations Conference on South-South Cooperation.

B. Private capital flows to developing countries

10. Foreign direct investment (FDI) to developing countries remained strong in 2014, reaching a new high of more than $700 billion, 4 per cent higher than in 2013, representing 56 per cent of global FDI. Flows to transitional economies were reduced by more than half, however, to $45 billion, as regional conflicts, sanctions on the Russian Federation and negative growth prospects deterred foreign investors (especially from developed countries). In 2014, China, with an increase in FDI of 3 per cent, became the world's largest recipient of such investment.[6]

11. Simultaneously, outward FDI from developing economies continued to increase, particularly from China, including from Hong Kong. In 2014, multinational corporations in developing economies alone invested almost $500 billion abroad, a 30 per cent increase from the previous year. Their share in global FDI reached a record 36 per cent, up from 12 per cent in 2007, the year

[5] Many partners participating in South-South development cooperation do not publish data on a yearly basis. Figures are based on data collected in preparation for the forthcoming second *International Development Cooperation Report* (Department of Economic and Social Development).

[6] UNCTAD, Global Investment Trends Monitor, No. 18, 29 January 2015.

before the financial crisis. In 2014, Hong Kong and China were the second and the third largest investors in the world, after the United States of America.[7]

12. Portfolio equity inflows rebounded significantly in 2014 from a sharp decline in 2013, reaching about $140 billion, driven by a renewed search for yield. By mid-2014, such flows increased significantly to countries in Asia and Latin America, including Brazil, India, Indonesia and Mexico. Inflows also increased in other markets, including in South Africa and Turkey. By contrast, portfolio debt inflows continued to decline in 2014, falling from $390 billion in 2013 to $310 billion. Despite this decline, debt inflows are noticeably higher than the pre-crisis peak levels.[8]

13. Cross-border bank flows increased by 6 per cent in 2014,[9] but continued to demonstrate high volatility.[10] Lending to China increased most — by 21 per cent. The surge in international lending to China has consisted primarily of lending to banks, most commonly in short-term claims. The share of outstanding international claims on China with a remaining maturity of one year or less has increased from 59 per cent at the end of 2008 to 78 per cent at the end of 2014. At the same time, the share of cross-border bank claims denominated in United States dollars has declined in many large emerging market economies. In the case of China, that ratio dropped by 15 percentage points, from 54 per cent at the end of 2008 to 39 per cent at the end of 2014. The dollar share of cross-border bank lending has also declined in the case of Mexico, the Russian Federation, Taiwan Province of China and Turkey.

C. External debt

14. At an aggregate level, the debt situation of developing countries appears to be generally benign, although debt burdens remain significant in some developed and developing countries. The external debt of developing countries measured 23.2 per cent of their GDP in 2014 as opposed to 35.4 per cent in 2000. As of 2015, the Highly Indebted Poor Countries initiative and Multilateral Debt Relief Initiative have managed to substantially reduce the debt burdens of eligible countries and the schemes are now almost complete, with 36 countries out of a total of 39 eligible countries at "completion point".[11] Just three prequalified countries, Eritrea, Somalia and the Sudan, have yet to start the debt relief process. Debt relief under the HIPC

[7] Ibid., No. 19, 18 May 2015; and UNCTAD, *World Investment Report 2015*, June 2015.

[8] *World Economic Situation and Prospects 2015*, update as at mid-2015, Department of Economic and Social Affairs, 2015.

[9] Bank for International Settlements, international banking statistics at end-December 2014, Monetary and Economic Department, April 2015.

[10] Total private capital flows are equal to flows of direct, portfolio and "other" investment. However, the definition of "other" investment, as reported by IMF, recently changed — it now includes also a number of items of official (Government) flows. The present report uses "bank flows", as reported by the Bank of International Settlements, as a proxy for the flows of private non-direct and non-portfolio investment. It is important to keep in mind that the sum of bank flows, direct and portfolio investment is not exactly equal to total capital flows.

[11] Chad reached the completion point at the end of April 2015; there are presently no "interim heavily indebted poor countries" that have reached the decision point under the HIPC initiative but have not yet reached the completion point.

initiative and Multilateral Debt Relief Initiative helped free up funds for additional expenditure, including for poverty reduction.

15. More recently, in response to the Ebola crisis, the International Monetary Fund (IMF) established the Catastrophe Containment and Relief Trust, which allowed $100 million worth of new debt relief for Guinea, Liberia and Sierra Leone, which had already reached completion point under the Highly Indebted Poor Countries initiative.

16. While the external debt to gross domestic product (GDP) ratio of all low- and middle-income countries has declined significantly since the early 2000s, the aggregate masks the rapid build-up of debt in a group of "small States",[12] within which a number of countries have been caught in debt difficulties over a long period of time, exhibiting very high debt-to-GDP ratios. In addition, the proportion of short-term debt in the external debt stock has been growing in recent years in a number of developing countries.

17. The ratios of external debt servicing to exports has also begun to rise, although they remain below the levels recorded in the early years of the millennium. Due to the likelihood of future increases in interest rates, a growing risk of debt vulnerability in countries that have roll-over risks requires effective management. In particular, a number of lower-middle-income and low-income countries, including some that benefited from the Highly Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative, have issued bonds in international markets in recent years. There is a risk that some countries will have problems refinancing their debt when interest rates rise. Sound fiscal policies and prudent debt management strategies can help attenuate these risks.

D. Global imbalances and reserve accumulation

18. After narrowing modestly in 2013, the global scale of current account imbalances, and of excess imbalances, held steady in 2014. Excess deficits and surpluses narrowed in some cases, but widened in others. This follows large increases over the past several decades, with the ratio of reserves of all countries to gross world product increasing from about 2 per cent in the 1960s to over 15 per cent by 2014. An unfinished policy agenda to reduce excess imbalances remains. Efforts by both surplus and deficit economies would be mutually reinforcing and would support growth.

19. Nevertheless, global imbalances are significantly below the pre-recession peak of 2007. While the United States remains the country with the world's largest deficit, its current account deficit has fallen from 5 per cent of GDP in 2007 to 2.4 per cent in 2014. Among the major surplus countries, China has a current account surplus that has fallen from more than 10 per cent of GDP in 2007 to about 2 per cent in 2014: significant appreciation of the yuan from 2007 onwards helped to redirect the Chinese economy towards a pattern of greater consumption and more imports. Germany's surplus has continued to rise, equalling 7.5 per cent of GDP, which has helped push the eurozone's combined surplus to a new record, a trend that may be reinforced by the weakening of the euro. The decline in the prices of oil

[12] "Small States" is a classification used by the Commonwealth Secretariat. Thirty-one member States of the Commonwealth are classified as small States.

and other commodities has led to lower deficits in several large commodity-importers and smaller surpluses, and even deficits, in major commodity-exporters, notably Saudi Arabia and other States members of the Gulf Cooperation Council.[13]

20. Reserve accumulation in emerging-market and developing economies has fallen substantially. In 2014, reserves in these countries increased only by $66 billion, whereas in the period from 2007 to2013 the annual increase in reserves for this group of countries was in the range of $439 billion to $1.22 trillion.[14]

21. The reasons for reserve accumulation vary. Reserves provide "self-insurance" against potential external shocks in current accounts (due mostly to the fluctuations in commodity prices) and in capital accounts (due to the volatility of capital inflows and outflows). At the same time, reserves can be a by-product of export-led growth strategies that maintain an undervalued currency through interventions in the currency market.

22. There are opportunity costs related to the greater build-up of reserves — these are savings of developing countries that are generally invested in the Government bonds of developed countries, which are used to finance investment and consumption in the developed countries. However, the gains from the accumulation of reserves — in the form of faster growth of exports, employment and output — may exceed the costs of putting aside part of the national savings.

23. Several significant developments will affect external positions in 2015: sharply lower oil prices; cyclical divergence and different monetary policies among the major economies; and related currency movements. The pattern of projected near-term changes in current accounts is dominated by the impact of the drop in oil prices, although this pattern will be partly offset by related currency movements and by eventual expenditure responses.

24. Recent changes in real effective exchange rates, near 10 per cent in some cases, have also affected current accounts in 2015. The pattern of recent movements in the value of major currencies, together with recent monetary policies, has had beneficial impacts for the global economy, including the easing of global financial conditions. At the same time, the future global financial environment will be complicated by the diverse risks associated with the process of exit from especially accommodating monetary policies, with the potential to disrupt markets and impact the real economy in countries worldwide. Emerging markets and countries with excess current account deficits are likely to be the most vulnerable. Policymakers should be prepared to respond flexibly to changing financial conditions using a range of tools, including strengthening policy frameworks and capital account management.

[13] Department of Economic and Social Affairs, *World Economic Situation and Prospects 2015*, update as at mid-2015, 2015.

[14] IMF, *World Economic Outlook, 2015: Uneven Growth: Short- and Long-Term Factors*, April 2015.

III. Strengthening the international financial architecture in support of the post-2015 development agenda

A. Strengthening international financial regulation

25. The Addis Ababa Action Agenda includes an agreement to "hasten completion of the reform agenda on financial market regulation, including assessing and if necessary reducing the systemic risks associated with shadow banking, markets for derivatives, securities lending and repurchase agreements".[15] Governments also committed to addressing the risk of "too-big-to-fail" financial institutions, and addressing cross-border elements in effective resolution of troubled systemically important financial institutions.

26. The current approach to the reform of international financial regulation has focused primarily on ensuring the safety and soundness of the financial system, centred on the banking sector through Basel III. Basel III reforms include higher minimum capital requirements, an improved quality of capital, a leverage ratio and larger liquidity buffers (inclusive of off-balance sheet obligations).[16]

27. The Addis Ababa Action Agenda stresses that the policy and regulatory environment should support the stability of the financial markets and promote financial inclusion in a balanced manner, including appropriate consumer protection. Striking a balance between stability — particularly in reducing systemic risks — and ensuring access to credit, particularly for higher risk lending in areas that can be critical for achieving sustainable development, remains a complex challenge for policymakers since there can be trade-offs between the two. As a result, there has been an increasing focus on the unintended consequences of the Basel regulations, in particular on long-term financing, trade finance, small and medium-sized enterprise financing and other areas of importance for achieving sustainable development. In response, some countries have made adjustments. For example, concerned with the risk of reduced lending to small and medium-sized enterprises, the European Union has reduced capital requirements on such exposures in the calculation of capital conservation buffer requirements.[17]

28. To address the issue of "too-big-to-fail", the Financial Stability Board has suggested that global systemically important financial institutions should have a total loss-absorbing capacity beyond the general standards of Basel III, that they should develop recovery and resolution plans (also known as living wills) and that countries should prioritize this approach in national regulatory frameworks. The Financial Stability Board has also called for the adoption of cross-border cooperation agreements, and it is developing rules to protect smaller economies that host subsidiaries of global systemically important financial institutions. Most large international banks are on course to meet the new Basel III capital ratios. In 2014 the largest banks in the survey, including global systemically important financial

[15] General Assembly resolution 69/313, annex, para. 109.

[16] Basel III introduced two required liquidity ratios. The "Liquidity Coverage Ratio" was supposed to require a bank to hold sufficient high-quality liquid assets to cover its total net cash outflows over 30 days; the "Net Stable Funding Ratio" was to require the available amount of stable funding to exceed the required amount of stable funding over a one-year period of extended stress.

[17] Basel II, para. 231 (definition of retail exposures), and article 501 of the Capital Requirements Regulations.

institutions, were only $4.4 billion short of meeting the 7 per cent target ratio (including the capital conservation buffer for larger banks), down from $62 billion in 2013.

29. Despite the increasing awareness of the systemic risks posed by global systematically important financial institutions, structural reforms, meant to separate core banking activities from market-based activities, have yet to be adopted in many countries. Discussions are also ongoing on a leverage ratio as a credible supplementary measure to risk-based capital requirements. Any final adjustments to the definition and calibration of the minimum leverage ratio (currently set at 3 per cent) will be made by 2017. Large banks, however, began to publicly disclose their leverage ratio to their national supervisory bodies on 1 January 2015.

30. More generally, complex regulations can be difficult to implement and supervise in many countries. This argues for broad-based and simple regulations that incorporate both balance sheet and off-balance sheet exposures and incorporate counter-cyclical measures. Nonetheless, there would still be a risk that lending requiring higher capital would shift from regulated banking activities to shadow banking.

31. According to Financial Stability Board data, shadow banking [18] grew by $5 trillion from 2013 to 2014, to about $75 trillion worldwide. The Board has spearheaded the process of designing a framework for managing systemic risks in the shadow banking system with the goal of preventing such risks from impacting the regulated banking sector. According to the Board, while advanced economies, by virtue of their size, have the largest shadow banking sectors, the fastest growth rates are in emerging-market economies. For example, shadow banking has increased most rapidly in Argentina, which saw a 50 per cent jump, and in China, where growth was more than 30 per cent. It is important to note, however, that shadow banking has a different profile in the developing countries than in the developed countries. In some countries, it includes elements of inclusive finance, that is, non-bank financial intermediaries that fill an important credit gap. This underscores the point made in the Addis Ababa Action Agenda regarding the importance of including all forms of financial intermediation in a robust regulatory framework, as well as of supporting financial stability and financial inclusion in a balanced manner.

32. The 2008 crisis also exposed risks associated with unregulated derivatives, which dramatically increased leverage in the financial system. Risks were noted particularly in the over-the-counter derivatives market, including a lack of transparency regarding counterparty exposures, insufficient collateralization and uncoordinated default management. The Financial Stability Board has reported some progress on implementation of reforms approved by the Group of 20 to make derivative markets safer, with all 19 member jurisdictions of the Board having at least some reporting requirements in force, or having adopted legislation or requirements in this regard. Although it is expected that 10 member jurisdictions of the Board will have mandatory clearing requirements for some products in effect by

[18] The term "shadow banking" is sometimes used to refer to unregulated financial intermediation that facilitates the creation of credit; however, the Financial Stability Board defines shadow banking as credit intermediation involving entities and activities outside of the regular banking system.

the end of 2015, over-the-counter derivatives trading continues at near pre-crisis levels.

33. Significant differences remain between countries regarding the degree to which regulatory banking frameworks have been implemented, as well as the interpretation of the legislation into national guidelines. Some argue that rules should be implemented in a coordinated and consistent manner as differences can lead to a watering down of standards. However, others consider that differences are necessary given different institutional country frameworks. The recent inclusion of more emerging markets in the plenary of the Financial Stability Board (Argentina, Indonesia, Saudi Arabia, South Africa and Turkey) is thus an important step in order to ensure that a wider range of perspectives is taken into account in international standard and norm-setting. In this regard, in the Addis Ababa Action Agenda, world leaders recommitted themselves to broadening and strengthening the voice and participation of developing countries in international economic decision-making and norm-setting and in global economic governance.

B. Multilateral reform

Global financial safety net

34. Since the 2008 world financial and economic crisis, world leaders have repeatedly stressed the need for an adequate global financial safety net.[19] A safety net can provide liquidity in times of systemic crisis, reducing the incentive for countries to accumulate excess reserves as a form of self-insurance against adverse shocks. The Addis Ababa Action Agenda also recognizes the need to strengthen the permanent international financial safety net, including a strong IMF and its cooperation with regional financial institutions, while safeguarding their respective independence. In this regard, IMF has quadrupled its lending resources since the 2008 global crisis and has introduced several new financing instruments with the key objective of reducing the perceived stigma of borrowing from the Fund and encouraging countries to ask for assistance before they face a full-blown crisis. These instruments include: the Flexible Credit Line, which provides large and up-front access to IMF resources for members with very strong fundamentals; policy implementation and institutional policy frameworks; and the Precautionary and Liquidity Line, which provides financial support to countries with sound fundamentals, policy implementation and institutional policy frameworks, but some remaining vulnerabilities.

35. IMF has also relaxed timing limitations on the precautionary use of the Standby Credit Facility, extended the permissible initial duration of Extended Credit Facility arrangements, increased the flexibility in the phasing of disbursements, allowed for ad hoc augmentation of arrangements in some circumstances and eased the poverty reduction strategy documentation requirements of the Extended Credit Facility and the Policy Support Instrument. In addition, the Rapid Credit Facility within the Poverty Reduction and Growth Trust allows limited conditionality for low-income countries facing an urgent balance of payments need.

[19] See, for example, recent communiqués by the Group of 20, IMF (International Monetary and Finance Committee), Fortaleza Declaration adopted by Brazil, the Russian Federation, India, China and South Africa (BRICS group of countries) and the Addis Ababa Action Agenda.

36. In order to preserve the Fund's ability to provide financial support to low income countries, the IMF Executive Board decided to distribute to the membership, in proportion to their quota shares, $1.75 billion in special drawing rights (about $2.7 billion) from the general reserve attributed to windfall profits from the sale of gold. This distribution was subject to the provision of satisfactory assurances by members that they will make new concessional lending subsidy contributions equivalent to at least 90 per cent of the amount distributed. The provision was met in October 2013 and as of 15 April 2015, 155 countries, representing 94.37 per cent of the participating countries, pledged to use their proportion of the distribution to subsidize lending to low-income countries.[20]

37. In advance of the third International Conference on Financing for Development, IMF reformed its lending architecture to expand access to its concessional resources and to provide the poorest countries with a wider safety net to handle unanticipated shocks.[21] The key measures include raising access norms to all concessional facilities by 50 per cent, rebalancing the funding mix of concessional to non-concessional financing under blended arrangements and setting the interest rate to zero for Rapid Credit Facility loans to low-income countries with an urgent balance of payments need.

38. The global financial safety net consists of a multilayered structure with global, regional, bilateral and national components. Whereas the largest element of the safety net is provided by IMF (at $1.25 trillion), a range of regional and multilateral financing arrangements have emerged to provide additional liquidity. More permanent frameworks of liquidity lines among key central banks remain pivotal for a functioning global safety net. For example, in October 2013, the United States Federal Reserve institutionalized the dollar swap lines that were put in place in 2008 during the global financial crisis in coordination with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan and the Swiss National Bank, totalling $333 billion. Moreover, within the last eight years the People's Bank of China has entered into swap agreements totalling 3.14 trillion yuan ($510 billion), including with Uzbekistan, the Republic of Korea and the European Central Bank. In addition, there is a recent rise of small regional swap agreements between the central banks of other Asian economies, including Japan, the Republic of Korea, India, Indonesia and the Philippines.

39. The permanent European Stability Mechanism, active since 8 October 2012, has provided financial assistance to Cyprus and Spain. In July 2014, Brazil, the Russian Federation, India, China and South Africa (the "BRICS" group of countries) signed a treaty establishing a contingent reserve arrangement to address short-term liquidity pressures, promote further cooperation among the member countries, strengthen the global financial safety net and complement existing international arrangements.[22] The regional financial safety net for South-East Asia, the Chiang Mai Initiative Multilateralization, founded in 2010, had doubled in size, to $240 billion, by July 2014, and its secretariat, the Association of South-East Asian Nations (ASEAN) "Plus Three" Macroeconomic Research Office, was

[20] www.imf.org/external/np/fin/prgt/second.htm.

[21] *Financing for Development: Enhancing the Financial Safety Net for Developing Countries* (IMF, Washington, D.C., 2015).

[22] Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, sixth BRICS summit, 15 July 2014.

upgraded into an international organization in October 2014. However, although the Chiang Mai Initiative has been in place for 15 years, it has not yet been called on, although the Latin American Reserve Fund, which operates independently, has been used frequently since it was established in 1978, despite its relatively small size.

40. Despite the progress described above, most of the regional safety net mechanisms are still insufficient to offer an adequate safeguard in times of emergency. Efforts to further strengthen crisis-lending facilities should focus on enhancing the various layers of the financial safety net and strengthening cooperation among the mechanisms at different levels. Enhancing cooperation and increasing complementarities between regional and global multilateral financing arrangements would contribute to global financial stability and sustainable growth.

Macroeconomic surveillance

41. IMF has increased its focus on the impact of risks to global stability emanating from the financial sector. The 2012 financial surveillance strategy lays the foundation for developing a unified macrofinancial framework that takes into account the interdependencies of financial sectors, linkages between financial conditions and macroeconomic stability and interactions between macroeconomic and macroprudential policies in the medium-term. In December 2013, the adoption of a revised methodology for determining jurisdictions with systemically important financial sectors expanded the number of countries that must undergo mandatory financial stability assessments to 29.

42. In October 2014, IMF completed its latest triennial surveillance review. The review examined the way the Fund conducted its economic and financial analysis and formulated policy advice. In that review the Fund found that recent reforms had led to an increased focus on risk-based surveillance, which had improved information capture of global economic and financial interconnections. However, the review also revealed that there was still significant scope to more effectively exploit the synergies between and among bilateral and multilateral surveillance. The IMF Executive Board called for more systematic analysis of outward spillovers and spillbacks in systemic countries and for greater quantification of the impact of risks and spillovers on recipient countries. While the review also raised a question about whether the IMF mandate was sufficient to support a stronger role of the Fund in global cooperation, a proposal for an expert group to explore this question was not supported by the Executive Directors.

Governance reform at the Bretton Woods institutions

43. The Addis Ababa Action Agenda calls for further increases in the voice and representation of developing countries in norm-setting processes and decision-making bodies, including IMF, the World Bank and the Basel Committee on Banking Supervision.[23] The IMF Executive Board and its Board of Governors approved changes to the Fund's governance in 2010, in connection with its 14th General Review of Quotas. These are seen as important steps towards a more representative, responsive and accountable governance structure. The reforms would double member countries' quotas while shifting voting rights to underrepresented members, including emerging-market and developing countries. The 2010 reforms

[23] Resolution 69/313, annex, para. 106.

also envisaged an all-elected Executive Board, including increased representation for emerging and developing countries. These reforms were agreed upon as a single package, which requires an amendment to the IMF Articles of Agreement.

44. In order for the proposed amendment to enter into force, acceptance by 113 IMF members having 85 per cent of the Fund's total voting power is required. As of June 2015, 147 members of IMF, with 77.25 per cent of total voting power, had accepted the amendment. Ultimately, adoption depends upon the acceptance by the IMF's largest shareholder, the United States, which has, to date, not been forthcoming.

45. IMF voting rights are guided by a quota formula, which was last recalibrated in 2008. Under the 2010 reforms, the quota formula was to be revamped by January 2013, with a new agreement on voting power redistribution to be reached by January 2014 in the context of the 15th General Review of Quotas. The quota formula had review yielded some agreements, including that GDP should remain the most important variable in any revamped quota formula, however the Executive Board agreed that achieving broad consensus on a new formula would best be done at the same time as the 15th General Review.[24]

46. In January 2014, the IMF Executive Board concluded that additional time would be needed to complete its work on the 15th General Review of Quotas.[25] In February 2015, the IMF Board of Governors adopted a resolution calling for the completion of the 15th General Review by 15 December 2015, the deadline under the Articles of Agreement. At the same time, the Governors called on the Executive Board to work expeditiously and to complete work on interim steps to make meaningful progress in key areas covered by the 2010 reforms pending their full implementation. This work is still ongoing.

47. In 2010, the World Bank's shareholders agreed to conduct shareholding reviews at the International Bank for Reconstruction and Development every five years so as to reflect economic changes. Voting reforms agreed upon in 2008 focused on the smallest and poorest countries, while in 2010 they focused on middle-income countries and donors to the International Development Association. A third Executive Board chair for Sub-Saharan Africa was also created in 2010.

48. The stated objective of the 2010 phase was to ensure that the World Bank is relevant, effective, and legitimate with a committee of the Bank's Governors stressing the importance of moving "towards equitable voting power" in the World Bank over time through the adoption of a dynamic formula which primarily reflects countries' evolving economic weight and the development mission of the World Bank.[26] As a result, the voting power of developing and transition countries increased from 42.7 per cent in 2008 to 45.1 per cent in July 2015, and it is expected to be increased to 47.2 per cent by March 2017. However, some developing countries argue that the reforms still fall short of full representation of all countries, particularly the least developed countries. The Board of Executive Directors of the World Bank Group have started working on the 2015 review, which

[24] IMF, Executive Board Reports on the Quota Formula Review, 30 January 2013.

[25] IMF, 2010 Reforms and the 15th General Review of Quotas, report of the Executive Board to the Board of Governors, 16 January 2014.

[26] World Bank Group/IMF, Development Committee Communique, April 2010.

aims to "arrive at a benchmark for a dynamic formula", which can be used for selective capital increases.

External debt restructuring

49. As the Highly Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative have shown, debt relief is critical for putting countries on a sustainable path. However, there is a growing consensus, based on the recent experiences of Greece and Argentina in particular, that the processes for resolving sovereign debt crises need improvement. Processes remain decentralized and ad hoc, in that a country in debt crisis has to approach its different classes of creditors for a restructuring of obligations. Alternatively, it may approach a Government or an international institution to lend it funds with which to pay maturing obligations that its regular creditors will no longer roll over. The first European crisis loans to Greece were a case in point of the latter.

50. Although sovereign debt restructurings do take place, these are often "too little too late". In practice, solvency problems are often dealt with by extending payment terms, but without "haircuts" or write-downs in the nominal value of debt owed. These types of restructurings often do not restore debt sustainability and market access, leading to repeated restructurings and dependence on official financing.

51. Until now, the Paris Club, the existing ad hoc machinery for restructuring bilateral official debt by some creditor countries, has only been used for restructuring the debt of developing countries. The high debt levels in some advanced countries may require debt restructuring to resolve the same problems, but there are no precedents or fixed rules for restructuring the bilateral official debt of these countries.

52. Restructuring of bank debt is typically managed through informal advisory clubs of banks known London Clubs. In addition, bond debt now represents a significant share in the composition of the overall debt of developing countries. The architecture for debt restructuring is thus fragmented. Restructuring of the various components of debt cannot be resolved under one umbrella entity, entailing different platforms, which can lead to delays in restructuring and high costs for debtors. From a creditor perspective, the present non-system does not ensure inter-creditor equity.

53. The challenges for a timely and adequate resolution of bonded debt problems are related to creditor coordination and the threat of litigation by hold-out creditors. In recent years, almost 50 per cent of sovereign defaults involved legal disputes abroad (compared to just 5 per cent in the 1980s), affecting 25 countries. Distressed debt funds were involved in 75 per cent of litigation cases.[27]

54. Governments in Latin America and Africa were most affected, accounting for 79 and 27 creditor lawsuits, respectively. Most debt crisis-related cases have been filed against middle-income countries. Nearly 30 per cent of all lawsuits were launched against highly indebted poor countries, or 34 out of 120 cases.[27] The outcomes of these disputes have increasingly strengthened the hands of holdout creditors.

[27] Julian Schumacher, Christoph Trebesch and Henrik Enderlein, "Sovereign Defaults in Court: The Rise of Creditor Litigation", May 2014.

55. There is a lack of systematic research on creditor returns in litigation, but at times they have been high. For instance, the litigators achieved an estimated gross return of 400 per cent in litigation against Peru, 60 per cent against Panama and (a presumed) 270 per cent against Yemen.[28]

56. There has been a response to these difficulties at the international policy level. In October 2014, the IMF Executive Board endorsed a modified *pari passu* clause that explicitly excluded the obligation to pay creditors on a rateable basis. Furthermore, following close work with the International Capital Markets Association, the IMF Executive Board endorsed key features of an enhanced collective action clause, including a single-limb voting procedure, to reduce the ability of minority holdout creditors to undermine a bond exchange favoured by the majority of affected bondholders.[29] Since then, a number of countries have adopted key features of these recommendations in their new international debt issuances.

57. The drawback is that these changes do not affect the already existing stock of debt accumulated without these new clauses, and it would take years for a sufficient stock of debt of a country to be covered by the new clauses. The existing stock of debt remains vulnerable should a country need to restructure it in the interim period. Moreover, the underlying assumption in the rationale for aggregation is that no single investor has the scale of resources to build a blocking position when a series of bonds is aggregated. However, for countries with fewer bonds and small volumes, aggregate clauses cannot prevent investors from building up a position large enough to block restructuring. Furthermore, this improvement in contractual language applies only to bond contracts.

58. Another concern with the current practice is that the official community inappropriately pays for the exit of private capital from countries in debt crisis, as seems to have been the case in Greece. The IMF's Executive Board is currently proposing reforms to the IMF lending framework with two key elements: (a) the introduction of a "debt re-profiling" option to make the Fund's lending framework more flexible in cases where debt is assessed as sustainable but not with high probability; and (b) the elimination of the systemic exemption that, in the view of IMF staff, has proven to be ineffective at mitigating contagion and does not constitute a coherent solution to addressing spillovers from a sovereign debt crisis. IMF is seeking to strike a carefully thought out balance between financing and adjustment and managing spillover effects from any needed debt operation.[30]

59. The international community called for an examination of enhanced approaches to sovereign debt restructuring in the Monterrey Consensus, and reiterated that request in outcome documents of major United Nations conferences and General Assembly resolutions. Most recently, pursuant to Assembly resolution 68/304, entitled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes", the Assembly, by its resolution 69/247, established the Ad Hoc Committee on Sovereign Debt Restructuring Processes for the discussion of principles and possible institutional processes to overcome

[28] Ibid., see appendix, "Creditor Returns to Litigation", "... the returns do not account for procedural costs, in particular, funding costs and legal costs".

[29] See "IMF supports reforms for more orderly sovereign debt restructurings", available from http://www.imf.org/external/pubs/ft/survey/so/2014/NEW100614A.htm.

[30] See IMF, "The Fund's Lending Framework and Sovereign Debt — Preliminary Considerations"; and United Nations Millennium Development Goals Gap Task force report 2014.

shortcomings in addressing sovereign debt. The Ad Hoc Committee concluded its work, endorsing the summary by the Chair of the Committee, in July 2015. However, the issue has proved to be a highly contentious one among borrowing and lending Governments, investors in sovereign bonds and the public at large. The challenge for the international community is to deal appropriately with high debt burdens where they arise, to help developing countries prevent the build-up of unsustainable debts and to support countries whose sustainable debt situations are suddenly rendered unsustainable by natural catastrophes, conflict or global financial disturbances.

IV. Encouraging longer-term investment for sustainable development

60. To address the enormous financing needs of sustainable development, both public and private sources of financing will be needed. While public financing, both national and international development assistance, will remain essential for many countries and sectors, it will not be sufficient on its own, and there is also an urgent need to mobilize long-term private investment in critical areas such as infrastructure (transport, energy, telecommunications and roads), human resources, health, the green economy and the financing of small and medium-sized enterprises.

A. Mobilizing longer-term investment in infrastructure

61. Although investment in infrastructure is particularly critical, including in energy, water, sanitation, transport and agriculture, in order to support growth, employment, structural transformation, social inclusion and environmental sustainability, there is an enormous financing gap in all of these areas. While developing countries currently spend about $1 trillion a year on infrastructure, investment will need to increase by an estimated additional $1 trillion a year through 2020 in order to maintain current growth rates and to meet the future demands of industry and households.[31]

62. To address the gap in infrastructure financing, both supply and demand-side impediments must be addressed. On the project side, insufficient investment can be the result of an insufficient enabling environment and an inadequate pipeline of well-prepared projects that are worthy of investment. Preparing such projects entails broader infrastructure investment plans, which should be part of national sustainable development strategies. These plans need to be translated into concrete project pipelines. Since many countries lack the capacity to develop such plans, technical support needs to be an integral part of a global infrastructure strategy.

63. On the finance side, there are constraints on both public and private resources in all countries. Constrained public budgets limit the public resources available for infrastructure investment. At the same time, since the financial crisis traditional private providers of financing for infrastructure (such as commercial banks) have reduced their infrastructure lending. New regulations, such as Basel III, which

[31] See Department of Economic and Social Development, United Nations System Task Team, Working Group on Sustainable Development Financing, chap. 1, "Financing for sustainable development: review of global investment requirement estimates", chap. 1, New York, 2013.

imply a higher cost of capital for long-term investments, risk further constraining commercial bank infrastructure lending. In this regard, attention has been drawn to the potential of institutional investors as a source of longer-term finance for sustainable development. While some categories of institutional investors (especially those with longer-term liabilities, such as pension funds) may be considered important sources of longer-term financing, they currently less than 3 per cent of their investments are in infrastructure in either developed or developing countries. Many institutional investors are restricted to investing in liquid assets, precluding long-term investment in the real sector of the economy, and many do not have the in-house capacity to do the necessary due diligence to invest directly in infrastructure.

64. The Addis Ababa Action Agenda recognizes and seeks to address these challenges. At the national level, the Action Agenda stresses the need for countries to include resilient infrastructure investment plans in their national sustainable development strategies. It also emphasizes the importance of capacity-building, with the international community committing itself to ensuring technical support for countries to translate these plans into concrete pipelines of investible projects. The Agenda moreover encourages recent efforts by some private investors to develop new infrastructure platforms and calls for measures, such as reviews of compensation structures and performance criteria, to incentivize greater long-term investment.

65. A notable commitment in the Action Agenda is for the establishment of a new global infrastructure forum as a key pillar for achieving the sustainable development goals. Working with ongoing initiatives in the area of infrastructure finance, this platform will bring together relevant stakeholders, both private and public, to identify gaps and constraints, particularly for countries and sectors that are often overlooked, ensure that projects are environmentally, socially and economically sustainable and help mobilize financing from all sources.

66. Other commitments have been put forward by multilateral development banks. The World Bank, the African Development Bank, the Inter-American Development Bank, the European Bank for Reconstruction and Development and the Asian Development Bank have pledged to increase their level of lending to more than $400 billion over the next three years. In addition, Japan has announced $110 billion in additional financing for infrastructure. Furthermore, in addition to the new resources made available by the multilateral development banks, national development banks have also announced their intention to continue increasing financing and Canada and Italy have announced that they will launch new banks to invest in developing countries.

B. Conditions for effectively pooling public and private resources

67. Over the last decade, public-private partnerships, equity investments, guarantees and insurance have been increasingly used as mechanisms for using official resources to leverage private financing for the infrastructure sectors, including health, water and enterprise development. At the same time, it is necessary that these mechanisms be carefully assessed for their potential to deliver additional sustainable development and poverty reduction outcomes, while avoiding unnecessary liabilities on the public purse and the crowding out of local businesses

and transactions that would have otherwise taken place. The Addis Ababa Action Agenda calls on projects utilizing blended finance, including public-private partnerships, to be transparent, share risks and rewards fairly, include clear accountability mechanisms and meet social and environmental standards. The Action Agenda also calls for building capacity to enter into public-private partnerships, including with regard to planning, contract negotiation, management, accounting and budgeting for contingent liabilities. Governments are also committed to holding inclusive, open and transparent discussion when developing and adopting guidelines and documentation for the use of public-private partnerships, to building a knowledge base and to sharing lessons learned through regional and global forums.

C. Better alignment of private investment with sustainable development

68. At the same time as expanding the quantity and scope of private finance and investments, it is also important that they be better aligned with long-term performance and sustainability. In the Addis Ababa Action Agenda, world leaders pledged to promote sustainable corporate practices, including integrating environmental, social and governance factors into company reporting, as appropriate, with countries deciding on the appropriate balance of voluntary and mandatory rules. They further committed themselves to work towards harmonizing the various initiatives on sustainable business and financing, identifying gaps, including in relation to gender equality, and strengthening the mechanisms and incentives for compliance.

V. Conclusions

69. **Financing will be critical for the achievement of the sustainable development goals. The requirements are enormous, but, as noted by the Intergovernmental Group of Experts on Financing for Sustainable Development,[2] currently available global public and private savings would be sufficient to achieve this goal. The ultimate objective of the international financial system is to facilitate the flow of funds from savers to investors in the right sectors. The Addis Ababa Action Agenda calls for multilateral cooperation in order to put in place suitable regulatory and policy frameworks that promote both stability, particularly in reducing systemic risks, and access to finance in a balanced manner.**

70. **Strengthening the effectiveness of ODA and other types of development cooperation remains an imperative for the post-2015 development agenda. The Action Agenda contains a strong commitment to improve the quality, impact and effectiveness of development cooperation and to align activities with national priorities, including by reducing fragmentation, accelerating the untying of aid, promoting country ownership and increasing transparency and mutual accountability.**

71. **South-South cooperation is an important complement to, but not a substitute for, North-South cooperation. The Action Agenda calls on developing countries to further improve South-South cooperation in accordance with the**

provisions of the Nairobi outcome document of the High-Level United Nations Conference on South-South Cooperation.

72. **Developing countries remain exposed to sudden changes in financial market sentiment and volatility of private flows, especially cross-border bank flows. The Action Agenda emphasizes the need to sustain or strengthen frameworks for macroprudential regulation and counter-cyclical buffers to address possible systemic vulnerabilities in the financial system caused by capital flow surges and outflows.**

73. **The Action Agenda recognizes the importance of leveraging longer-term investment into sectors that enhance development, especially in low- and middle-income countries. An enabling domestic and international environment is needed to mobilize long-term private investment, both domestic and foreign, into critical areas such as infrastructure, human resources, health, the green economy and the financing of small and medium-sized enterprises.**

74. **With a view to ensuring a fundamental reform of the global financial system, the Action Agenda emphasized the need for change in the following four major areas: (a) completion of the reform agenda on financial market regulation, including building the resilience of financial institutions; (b) assessment and, if necessary, reduction of the systemic risks associated with shadow banking, with the aim of ensuring transparent and resilient market-based financing; (c) addressing the risk created by "too-big-to-fail" financial institutions; and (d) reducing the risks associated with the markets for derivatives in order to make those markets safer.**

75. **Further progress is needed to ensure that a wide range of perspectives is taken into account in international financial market reforms. In this regard, the Action Agenda calls for a greater voice for developing countries in standard- and norm-setting bodies.**

76. **Although the international financial safety net has been strengthened at the regional and international levels since the global financial crisis of 2008, it does not yet provide an adequate safeguard in times of emergency. Enhancing cooperation and increasing complementarities between regional and global financing arrangements would contribute to global financial stability and sustainable growth.**

77. **The challenges for a timely and adequate resolution of sovereign debt problems, in particular with respect to creditor coordination and the threat of litigation by hold-out creditors persist: a timely solution in cases of debt distress would ultimately reduce possible future costs for all stakeholders.**

78. **The global economic governance structures have to further evolve in order to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting. The implementation of the 2010 IMF quota and governance reforms would represent an important step forward and clear the way for a new agreement on the redistribution of voting power, which has been put on hold pending the implementation of the 2010 reforms.**